Internal Revenue Service

memorandum

CC:TL-N-7005-88
Br4:RBWeinstock

date: JUN 21 1988

to: District Counsel, Philadelphia
Attn. L. Primavera-Femia

from: Director, Tax Litigation Division

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subject: [redacted]

This is in response to your request for technical advice dated June 13, 1988.

ISSUE

Whether amounts received from a teaching fellowship were excludable from gross income under I.R.C. § 117 as a fellowship or scholarship because it falls within Rev. Rul. 75-280, 1975-2 C.B. 47.

BACKGROUND

Petitioner, [redacted] was a Ph.D. candidate in Chemistry at [redacted] and received amounts of $[redacted] for [redacted], $[redacted] for [redacted] 1/ and $[redacted] for [redacted] from teaching fellowships he had. He received W-2s from the University for those years which he attached to his tax return, but excluded the amount from the calculation of gross income on the basis that the amounts were excludable under I.R.C § 117.

The Appeals supporting statement indicates that most stipends at [redacted] were teaching assistantships and were mostly in the Chemistry Department. The assistants did not teach classes but rather monitored undergraduate laboratory sessions, conducted 'recitation' sessions in which they assisted undergraduates in completing and solving problems assigned in regular classes, graded tests and held office hours for students.

1/ Our understanding is that he also received a half year stipend in [redacted] for doing research which the Service found non-taxable.

[redacted] of [redacted] orally advised you that while generally students were required to teach 2 semesters, the student could under some circumstances engage in research in lieu of teaching and that the teaching was not an absolute requirement. In a conference, petitioner stated that if a person was paying his own tuition the person was then not required to teach, although he believed that two semesters of teaching was still required of all candidates.

The Chemistry Department issued a statement expressing a requirement that all graduate students be enrolled in a training assignment each term. These assignments varied according to the needs and professional aspirations of the student and were designed to supplement the more formal course work and expose the student to some of the types of activities in which the student will be engaged after the receipt of the degree. However, the requirement does not apply to students from outside the United States who may be excused from the training requirement.

ANALYSIS

For the years at issue I.R.C. § 117(a)(1) provided that gross income does not include any amount received as a scholarship at an educational organization described in I.R.C. § 170(b)(1)(A)(ii) or as a fellowship grant. I.R.C. § 117(b)(1) provided that for an individual who is a candidate for a degree at an educational institution described in section 170(b)(1)(A), the exclusion from gross income shall not apply to that portion which represents payment for teaching, research, or other services in the nature of part-time employment required as a condition to receiving the scholarship or the fellowship grant. If teaching, research or other services are required of all candidates (whether or not recipients of a scholarship or fellowship grants) for a particular degree as a condition to receiving such degree, such teaching, research, or other services shall not be regarded as part-time employment within the meaning of this paragraph. See also Treas. Reg. §§ 1.117-1(a), 1.117-2(a) and 1.117-4(c).

Treas. Reg. § 1.117-3(c) defines a fellowship grant as "an amount paid or allowed to, or for the benefit of, an individual to aid him in the pursuit of study or research." Whether a particular payment satisfies the general definition depends upon the nature of the activities carried on by the recipient, and the purpose of the grantor in making the payment. If a payment represents compensation for employment services or services which are subject to the supervision of the grantor, it is not excludable as a fellowship grant.

Rev. Rul 75-280, 1975-2 C.B. 47, held that stipends received by graduate students who performed certain research services

would be regarded as a scholarship or fellowship grant and not be regarded as part-time employment where the taxpayer was (1) a candidate for a degree at an educational institution, (2) the taxpayer performed research, training, or other services for the institution that satisfied then existing specifically stated requirements for the degree, and (3) equivalent services were required of all candidates for the degree.

Where the three conditions were met, Rev. Rul. 75-280 stated that the Internal Revenue Service would assume that the amounts paid were for the primary purpose of furthering the education and training of recipients in their individual capacity. The ruling stated however that the Service will not assume the primary purpose test was satisfied to the extent (1) the taxpayer performs services in excess of those required for the degree; (2) the taxpayer performs research, teaching or other services for a party other than the educational institution; (3) the grant is made because of past services or conditioned on performance of future services; or (4) the degree requirements, or the nature and extent of the work that is approved as satisfying the degree requirements, are not reasonably appropriate to the particular degree.

The issue of the section 117 exclusion and the application of Rev. Rul. 75-280 has received a certain amount of recent public scrutiny. A litigation guideline memorandum was recently issued stating that Rev. Rul. 75-280 is to be followed. This is consistent with Commissioner Gibbs' recent response to Senator Chiles of Florida who had inquired about a number of stipend cases involving graduate students. The Service also issued a news release on March 30 (IR-88-65) stating that if the three part test of Rev. Rul. 75-280 is met, the Service will assume that the amount of a stipend was for the primary purpose of furthering the taxpayer's education or training and is excludable from gross income.

From the material you have submitted to us, we do not believe that petitioner satisfies the three part test of Rev. Rul. 75-280, insofar as the services he performed were not required of all degree candidates. We note that the training assignments were not required of foreign students. Petitioner has also indicated that not all students were required to teach. Even if we viewed the teaching as satisfying the degree requirement, a student was only required to teach two semesters and this would be the specific degree requirement. Any teaching in excess of two semesters would be in excess of the degree requirements and subject to the restrictions on the three-part test that are clearly laid out in Rev. Rul. 75-280.

Furthermore, we believe that the language in Rev. Rul 75-280 stating that the primary purpose test will not be considered

satisfied where degree requirements, or the nature or extent of the work that is approved as satisfying the degree requirements, that are not reasonably appropriate to the particular degree, may be applicable in this case. In contrast to a specific two semester teaching requirement, the training assignment requirement is opened ended and can in fact last for many years (in the instant case three). The amount of training assignments for a particular degree candidate will depend on the length of time it takes the candidate to complete the program. Given the disparity between different candidates, it can be argued that the training assignments are not degree requirements. Even if the training assignments represent degree requirements, the requirement of a training assignment in excess of specifically stated teaching and research requirements are not reasonably appropriate to the Chemistry Ph.D.

While Rev. Rul 75-280 does not apply, this does not mean that petitioner fails to satisfy the primary purpose test. 2/ The question remains as to whether petitioner was paid to enable him to perform his research in his individual capacity or compensate him for past, present or future services. Adams v. Commissioner, 71 T.C. 477, 486 (1986); Zolnay v. Commissioner, 49 T.C. 389, 396 (1968); Smith v. Commissioner, T.C. Memo. 1986-274; Chen v. Commissioner, T.C. Memo. 1979-407. This is a question of fact. Zolnay v. Commissioner, 49 T.C. at 395. Under the facts, we believe that the Service would probably prevail. Jamieson v. Commissioner, 51 T.C. 635 (1969); Loudon v. Commissioner, T.C. Memo. 1988-145; Tate v. Commissioner, T.C. Memo 1984-206; Zimmerman v. Commissioner, 1984-207; Workman v. Commissioner, T.C. Memo. 1974-5.

You have advised us that in recent conversations with the Indianapolis Appeals Office, you have been informed that they are conceding cases involving facts similar to those in your case. It is our understanding that these cases are being viewed very liberally and if the taxpayers mention Rev. Rul. 75-280, and a cursory view of the files indicate that the ruling might apply, then we are conceding the cases. It is not clear if there are any differences in those cases. For example, those cases might not involve claims excluding several years' stipends.

2/ While the regulations and some courts have adopted the primary purpose test, Hembree v. United States, 464 F.2d 1262, 1264 (4th Cir. 1972), the Supreme Court set forth the quid pro quo test in Bingler v. Johnson, 394 U.S. 741 (1969), under which if there is any substantial quid pro quo, i.e., compensation for services, the payments cannot qualify for exclusion from income as "fellowship funds".

Insofar as this case does not fall within Rev. Rul. 75-280, we would have no objection to litigation. However, because of the administrative treatment provided similarly situated taxpayers, we also have no objection if you decide to concede this and similar cases.

In order to provide you with more background with respect to the issues in this case, we have enclosed copies of the appellate briefs in Rockswold v. United States and Reese v. Commissioner. We have also enclosed a copy of Loudon v. Commissioner, T.C. Memo. 1988-145, a recent opinion involving the section 117 exclusion. If you have any questions on the above or require further assistance, please contact Ronald Weinstock at (FTS) 566-3345.

MARLENE GROSS
Director

By: 
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Enclosures:
Rockswold brief
Reese Brief
Loudon opinion